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ABSTRACT

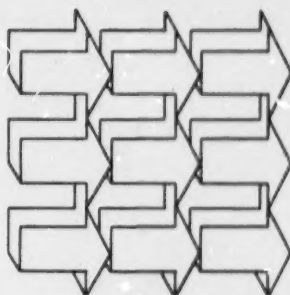
This lesson on the nature of small business, the first in a series of 18 units, is part of the first level of a comprehensive entrepreneurship curriculum entitled: A Program for Acquiring Competence in Entrepreneurship (PACE). (Designed for use with secondary students, the first level of PACE introduces students to the concepts involved in entrepreneurship and helps them become aware of entrepreneurship as a career option.) The following topics are covered in the unit: the definition of a small business, different types of small businesses, the ways in which small businesses contribute to the American way of life, the role that small businesses play in the American economic system, and the major factors contributing to the success of a small business. Included in the lesson are instructional text organized in a question-and-answer format, suggested individual and group learning activities, a case study, and assessment questions. (MN)

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PACE
REVISED

Program for
Acquiring
Competence in
Entrepreneurship



UNIT 1

☒ Level 1

☐ Level 2

☐ Level 3

Understanding the Nature of Small Business

Developed by M. Catherine Ashmore and Sandra G. Pritz

You will be able to:

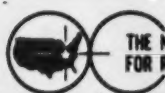
- Define a "small business."
- Identify the different types of small businesses.
- Describe how small businesses contribute to the American way of life.
- Describe what role small businesses play in the American economic system.
- Identify the major factors contributing to the success of a small business.

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BEFORE YOU BEGIN...

1. Consult the *Resource Guide* for instructions if this is your first PACE unit.
2. Read the Unit Objectives on the front cover. If you think you can meet these objectives now, consult your instructor.
3. Look for these business terms as you read this unit. If you need help with their meanings, turn to the Glossary in the *Resource Guide*.

economic doctrine
free enterprise system
gross national product
innovativeness

manufacturing
monopoly
small business
supply

UNDERSTANDING THE NATURE OF SMALL BUSINESS

WHAT IS THIS UNIT ABOUT?

Small business is the part of our economic system that is characterized by individual "enterprise" or the willingness to try new things. It is composed of "mom-and-pop" grocery stores, janitorial service companies, microcomputer manufacturers, bakeries, construction companies, hardware stores, boutiques, babysitting services, banks, consultants, and many other small businesses.

WHAT PART DID SMALL BUSINESS PLAY IN OUR HISTORY?

The history of America's growth cannot be separated from the history of our small businesses. The businesses of the American colonists provided the economic freedom that made independence worth the fight. They provided the funds that supported the Revolutionary Army and the infant government of Washington, Jefferson, Adams, and the other Founding Fathers. Small businesses resulted in the inventions of Thomas Edison, Ben Franklin, Eli Whitney, Alexander Graham Bell, and Henry Ford. In short, small businesses sparked both our capitalistic or "free enterprise" system of government and the rise of the American industrialist.

Recent small business contributions are no less impressive. As the Small Business Administration describes—

Independent small business entrepreneurs have been responsible for more than half of all the product and service innovations developed in the United States since World War II.

A recent review of the leading 500 technological innovations in the United States between 1953 and 1973 shows that small firms (defined as those with up to 1,000 employees) produce four times as many innovations as medium-sized firms (defined as those with 1,000 to 10,000 employees).

Nearly every major energy-related innovation in the past 100 years has been developed by small business. These include the electrical car, the air conditioner, the gasoline engine, the electric light, gasoline, and transformers.



Of the seven major innovations in the areas of petroleum refining since 1945, all were developed by small business.¹



Until recently, the achievements of small business in America were largely unrecognized. In his book *Small Business Management*, Nicholas Siropolis makes this same point. He summarizes the lack of recognition for small business by quoting from the classic book *A History of the Business Man* by Miram Beard:

Physicians are now wrapped in so much dignity that the public forgets how recently they occupied the status of barbers. Lawyers have climbed from the solicitor-family relation to a solemn eminence. . . . Not so the businessman; he still struggles on, unfathered and unhallowed. He is his own ancestor, and, usually, his memory does not reach back even to the last business crisis.²



**WHAT IS THE PLACE OF
SMALL BUSINESS IN TODAY'S
SOCIETY?**

Today, however, small businesses and entrepreneurs who start and run them are a hot topic of conversation. Educators, politicians, historians, and bankers are becoming eager to serve the needs of entrepreneurs. As David Gumpert said in a *Harvard Business Review* column—

Suddenly entrepreneurship is in vogue. Despite burdensome interest rates and a stagnant economy, the number of business incorporations as recorded by Dun & Bradstreet, rose to more than 500,000 in 1980 from 220,000 in 1975. And it's become fashionable for politicians and other policymakers to extol the innovativeness and job-creation potential of small businesses.³

Publishers are also rushing to supply information and educational materials on starting and managing small businesses. David Gumpert's column estimated that in the last four years, there have been over fifty new entrepreneurship books, three new magazines, and many new, small business columns in other magazines and newspapers such as *Forbes* and the *Wall Street Journal*. Most daily newspapers across the country now carry a regular small business column. Many also do regular feature stories on small businesses and entrepreneurs in the local area.

**HOW DOES THE SBA DEFINE
SMALL BUSINESS?**

Defining a small business is not an easy task. The Small Business Administration (SBA) definition is the one most commonly used. The SBA describes a small business as one that is individually owned and operated and that is not dominant in its field of operation.⁴

For its loan program, the SBA has established a small business definition that categorizes small businesses by size and industry. Of the more than 14 million businesses in the country, 99 percent are considered "small" businesses by SBA standards. The four basic industries are characterized in the following table.

Table 1

**U.S. SMALL BUSINESS INCOME AND EMPLOYMENT
BY INDUSTRY CATEGORY**

<u>Industry Group</u>	<u>Annual Receipts</u>	<u>Average Employment</u>
Wholesaling	\$9.5 to 22.0 Million	—
Services	\$2.0 to 8.0 Million	—
Retailing	\$2.0 to 7.5 Million	—
Manufacturing		250 to 2,500

SOURCE: U.S. Small Business Administration. *Business Loans from the SBA*. Washington, D.C.: U.S. Government Printing Office, 1981.

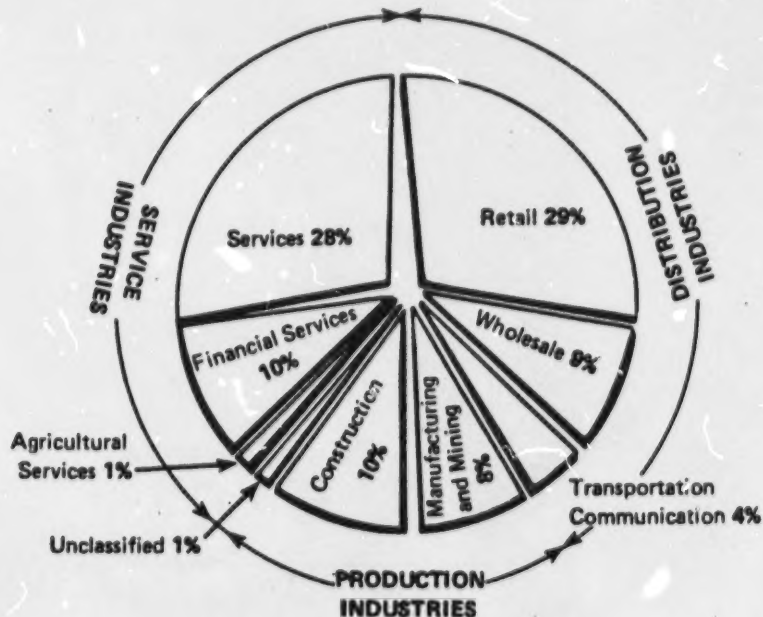
NOTE: On March 11, 1980, SBA proposed new size standards based on number of employees. The proposal is still under study. The standards listed here will remain in effect until an official ruling is made.

Wholesalers move goods between manufacturers and retailers for all types of businesses including groceries, hardware stores, and gasoline stations.

Services are either provided at the customer's home or at the place of business. Examples of service businesses include lawn care specialists, dry cleaners, accountants, travel agencies, and janitorial service companies. In the future, the growth of small businesses may be concentrated in service companies.⁵

Retailers are the biggest group of small businesses. They sell goods directly to the consumer through a store location. They include businesses such as florists, grocery stores, drugstores, restaurants, fast-food establishments, gas stations, and hardware stores.

Manufacturers are the smallest group of small businesses. They produce the goods that the wholesalers sell to the retailers, who in turn sell the goods to you. The pie chart in figure 1 shows the percentage of small business by industry.



SMALL BUSINESS BY INDUSTRY ²

Most small businesses are in the retail and service sectors.

SOURCE: Used with permission from the National Federation of Independent Business, Research and Education Foundation. San Mateo, CA: 1981.

**HOW DOES SMALL BUSINESS
CONTRIBUTE TO THE
AMERICAN WAY OF LIFE?**

Without the large number of small U.S. businesses that provide jobs as well as consumer goods, citizens would be much more limited in their opportunities and choices. The result of socialism (in medicine and broadcasting) in England is a good example of how the lack of small, independent enterprise limits personal choice. The limitations created by Russia's communistic economy are another good example.

**HOW DOES SMALL BUSINESS
CONTRIBUTE TO THE
ECONOMY?**

The growth of our economy is directly affected by the creativity and originality of those who open new small businesses. Such influence is illustrated by the theory of economist Joseph Schumpeter. Schumpeter's theory traces the flow of goods and profit to show that new wealth in the economy is created when individuals establish businesses outside the circular flow of normal business transactions. In these businesses, the individuals establish new "combinations" by creating new products and services. Schumpeter calls these new combinations "enterprises" and the people who establish them "entrepreneurs."⁶

Ayn Rand, who discussed the philosophy of private enterprise in *Atlas Shrugged*, explains:

If you ask me to name the proudest distinction of Americans, I would choose—because it contains all the others—the fact that they were the people who created the phrase "to make money." No other language or nation had ever used these words before; men had always thought of wealth as a static quantity—to be seized, begged, inherited, shared, looted, or obtained as a favor. Americans were the first to understand that wealth has to be created.⁷

In addition to being a major source of new wealth, small businesses provide jobs for 47 percent of the American work force. Firms with fewer than twenty employees generate 66 percent of all new jobs. Small businesses provide products and labor for big business. Because of their size, small businesses are more likely to locate in areas that are too remote for big business. This results in a more balanced use of our land and labor and wise conservation of our resources.

Minority-owned businesses account for 5.7 percent of all business. That is up from 4.4 percent in 1977. Tables 2 and 3 show the relationships by industry of all minority-owned businesses to the total number, and of all women-owned businesses to the total number of all businesses.

TABLE 2
FIRMS AND RECEIPTS OF MINORITY-OWNED AND ALL UNITED STATES FIRMS
BY SELECTED INDUSTRY DIVISIONS, 1977

Industry Division	[Firms, Thousands; Receipts, Billions of Dollars]					
	Firms			Receipts		
	[Minority-Owned]			[Minority-Owned]		
	Total	Number	Percent	Total	Amount	Percent
Total	9,440 ¹	518 ²	5.5	612.0	21.3	3.5
Construction	1,107	53	4.7	72.6	2.1	2.9
Manufacturing	287	13	4.2	38.5	0.9	2.3
Transportation, Communications, Utilities	419	37	8.6	22.8	0.9	3.9
Wholesale and Retail Trade	2,600	156	6.0	291.4	10.8	3.7
Finance, Insurance, Real Estate	1,404	28	2.0	66.6	0.7	1.1
Selected Services	3,623	234	6.5	120.1	5.9	4.9

¹Includes only sole proprietorships, partnerships, and small (Subchapter S) business corporations. For comparability purposes, this table excludes minority-owned firms filing Form 1120 tax returns (corporations other than Subchapter S small business corporations).

²Excludes unallocated firms and firms in "other" industries."

Sources: Department of Commerce, Bureau of the Census, *Survey of Minority-Owned Business, 1977*. Sole proprietorship and partnership data based on Internal Revenue Service, *Preliminary Report, Statistics of Income, Business Income Tax Returns, 1977*. Small business corporation data based on Internal Revenue Service, *Preliminary Report, Statistics of Income, Corporation Income Tax Returns, 1976*. IRS data are adjusted to exclude industries not covered by the Census survey of minority-owned firms.

TABLE 3
FIRMS AND RECEIPTS OF WOMEN-OWNED AND ALL UNITED STATES FIRMS
BY SELECTED INDUSTRY DIVISIONS, 1977

Industry Division	[Firms, Thousands; Receipts, Billions of Dollars]					
	Firms			Receipts		
	[Women-Owned]			[Women-Owned]		
	Total	Number	Percent	Total	Amount	Percent
Total	9,440 ¹	662 ²	7.0	612.0	40.4	6.6
Construction	1,107	21	1.9	72.6	2.9	4.0
Manufacturing	287	19	6.6	38.5	3.6	9.4
Transportation, Communication, Utilities	419	12	2.9	22.8	1.3	5.7
Wholesale and Retail Trade	2,600	228	8.8	291.4	23.4	8.0
Finance, Insurance, Real Estate	1,404	66	4.7	66.6	2.1	3.2
Selected Services	3,623	316	8.7	120.1	7.1	5.9

¹Includes only sole proprietorships, partnerships, and small (Subchapter S) business corporations. For comparability purposes, this table excludes women-owned firms filing Form 1120 tax returns (corporations other than Subchapter S small business corporations).

²Excludes unallocated firms and firms in "other" industries.

Sources: Department of Commerce, Bureau of the Census, *Women-Owned Business, 1977* and sole proprietorship and partnership data based on Internal Revenue Service, *Preliminary Report, Statistics of Income, Corporation Income Tax Returns, 1976*. IRS data are adjusted to exclude industries not covered by the Census survey of women-owned firms.

**HOW IMPORTANT IS THE
PROFIT MOTIVE IN THE
ECONOMIC SYSTEM?**

Most entrepreneurs in business are motivated primarily by a need to achieve. Many measure achievements through profits, or return on their investment. Without the hope of a reasonable profit, many entrepreneurs would stop creating new businesses. It is easy to see how our economic system and business community continuity are dependent on the profit motive.

**HOW DOES THE THEORY OF
SUPPLY AND DEMAND
AFFECT PROFIT?**

Our desire and ability to spend our money for certain goods and services is called demand. Supply refers to the quantities of a product offered for sale at a given time for a certain price. Successful producers are those who keep offering the goods and services that buyers want. Supply and demand ultimately determine the levels of production and employment in our country, and account for the birth and death of companies and entire industries.

**WHAT ARE THE MAJOR
FACTORS CONTRIBUTING TO
THE SUCCESS OF SMALL
BUSINESS?**

Here are the factors most often cited as contributing to a successful business venture:

- The entrepreneur is experienced and competent.
- The product or service chosen is in a unique or strong position when compared to the competition.
- Sufficient capital is available.
- Planning was completed prior to the start of production/operation.
- The entrepreneur conducts a self-analysis of personal strengths and weaknesses prior to the start of production/operation.
- The use of outside expert help was obtained where needed.

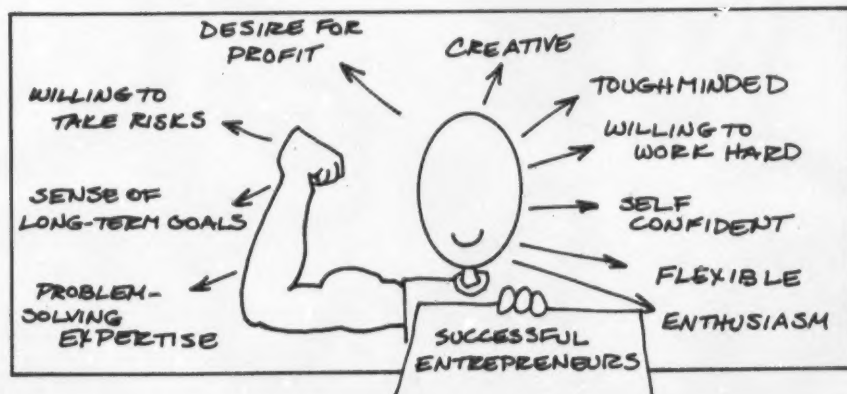


Jeffery Timmon, Leonard Smollen, and Alexander Dingee's book, *New Venture Creation*, offers a comprehensive look at why some businesses are successful while others are not. According to Timmons, the reasons for a higher success rate are (1) a capable lead entrepreneur, who has determined realistically his or her entrepreneurial strengths and shortcomings and has established a balanced and compatible entrepreneurial team; (2) a feasible business idea; and (3) appropriate financing.⁸

**WHAT ARE THE TRAITS MOST
OFTEN EXHIBITED BY
SUCCESSFUL
ENTREPRENEURS?**

The major characteristics of successful entrepreneurs have been identified as—

- tough-minded (not afraid to make decisions);
- hard-working (can go for days without the normal amount of sleep when involved in a project);
- self-confident (not cocky or arrogant);
- reasonable in risk-taking (takes a chance when success is not completely based on luck);
- flexible (can quickly stop work on one job and start working on another);
- creative (can put old ideas or pieces together in new and meaningful combinations);
- goalsetting (does not risk money in going after short-term profits only; considers the potential long-term profit);
- problem solving (prefers meeting and solving problems instead of avoiding them);
- profit-motivated (understands the relationship of profit to the economy).



One characteristic omitted from many of the lists is enthusiasm. Karl Vesper's book *New Venture Strategies* recommends that potential entrepreneurs try to pick up the personality characteristics and attitudes of already successful entrepreneurs. For help in acquiring "achievement motivation," Vesper suggests following the rules of Dale Carnegie and other how-to-be-successful authors.⁹



HOW RIGID ARE THE KNOWN ELEMENTS OF SUCCESSFUL BUSINESS?

The massive amount of new information on small business is still in the infant analysis stage. More is being learned every day. Against such rough data, people should be cautious in making decisions based on self-analysis.

Gordon Baty states this concern very succinctly in his book *Entrepreneurship for the Eighties*:

While it may be interesting to know this sort of average or modal information, much of it totally misses the point of entrepreneurship: the diversity (or if you will, statistical dispersion of variance) of traits that have historically characterized successful entrepreneurs. If you don't seem to fit neatly into the traits profile . . . you may take comfort from the fact that Edison, Ford, Land, and most of our other entrepreneurial geniuses probably wouldn't have either.¹⁰

ACTIVITIES

The following activities are designed to help you develop insights, opinions, questions, answers, and attitudes.

INDIVIDUAL ACTIVITY

List the reasons you have for opening a small business. Identify the kind of business you might choose.

INDIVIDUAL ACTIVITY

Do you remember the first time in your life you were motivated to do something for profit? Were you successful? How did you feel? Did you want to turn right around and reinvest the profit in another venture?

INDIVIDUAL ACTIVITY

How many of the products and services you use are produced by small business? How much do they add to the quality of your life? List at least twenty such products.

INDIVIDUAL ACTIVITY

Check your local newspaper to see how many items you can find on small business. Clip the articles and begin building a file to use while you are taking this course. A good file can also be a resource for choosing a small business for ownership or investment.

INDIVIDUAL ACTIVITY

As you begin building your own personal file on small businesses in your area, index your file by industry. Determine if there is a trend in your area for small business growth in one industry over another.

INDIVIDUAL ACTIVITY

Determine if any of the small business stories you have been collecting from the daily newspaper indicate the reasons for success of the business. Are they the same as the ones on the list in this unit? List the elements you think contributed most to the success of the companies.

INDIVIDUAL ACTIVITY

Check your favorite store and find out the products for which it is most difficult to estimate customer purchases. Why? List some of the reasons for the difficulty in estimating consumption levels.

GROUP ACTIVITY

With a group of four or five other students, review the list of small business products you consume. Think of them now in relation to the producers and/or sellers of the product. They had to estimate your need or desire for the product. If they overestimated, they were stuck with the inventory they couldn't sell. If they underestimated, you wouldn't be able to buy the product the next time you wanted it. List the products that you believe will continue to show a demand. List any you believe to be on the decline. Tell why you think so.

GROUP ACTIVITY

Use the list of small business products you developed for the previous activity. Make a master list of the improvements of your life-style through the products and services of these small businesses.

INDIVIDUAL ACTIVITY

Determine which of the characteristics of a successful entrepreneur seem to fit you. Which ones would you need to develop? Divide a piece of paper into two columns and list your strengths and weaknesses.

CASE STUDY

Kate Hansen is a homemaker in Columbus, Ohio. In 1977, while she was spraying the foliage of her houseplants, she got upset because the spray was getting on her walls, furniture, and floors. She tried

holding a newspaper behind the plant when she was spraying so that the overspray would collect on the paper before it could do any damage. However, the newspaper proved unwieldy and when it reached the saturation point, it no longer absorbed the water.

Next she took a gallon plastic bottle that had held household bleach and cut it in half. She held it behind the plants as she sprayed to catch the overspray. It worked perfectly.

It was a small step from the bleach bottle to an idea for a new invention that she called Misty.[™] Shaping it more like a Frisbee to increase the area of protection, she added a handle. The prototype models were extremely successful.

Kate then contacted some marketing experts. They found that the houseplant market in the United States was booming. Sales of "accessories" in the houseplant market offered excellent potential.

The methods for manufacturing and distributing Misty[™] that Kate and the market experts considered were—

- to contract with a plastics manufacturer who would produce the product for the cost of labor and equipment;
- to sell directly to retailers;
- to sell directly to customers;
- to use brokers and distributors (wholesalers) who would sell and distribute to the retail outlets;
- to sell the rights for manufacturing and distributing to a major manufacturer/distributor.

Kate had no personal experience in business other than as a secretary

However, she had a unique product, a substantial market, and good chances for profit.

While she did not have the personal resources to finance the business, Kate found that she would be able to get the capital needed from a financial institution.

Answer the following questions on a separate piece of paper.

1. If you were the entrepreneur faced with this opportunity, what steps would you take before making the next decision?
2. How many different industries are under consideration?
3. Which area of industry do you think it would be hardest for the entrepreneur to get started in? The easiest?
4. Can you think of any other uses for Misty?[™]

ASSESSMENT

Directions: Read the following assessment questions to check your own knowledge of the information in this unit. When you feel prepared, ask your instructor to assess your competency on them.

1. How does the Small Business Administration define a small business?
2. What are the traditional small business industries?
3. What does Schumpeter call "enterprises" and how do they contribute to the economy?
4. How do small businesses contribute to the American way of life?
5. What are some of the major factors contributing to the success of a small business?

NOTES

- ¹ U.S. Small Business Administration. Public Commission Division. *Facts About Small Business and the U.S. Small Business Administration*. Washington, D.C.: U.S. Government Printing Office, February 1981.
- ² Siropolis, Nicholas C. *Small Business Management: A Guide to Entrepreneurship*. 2nd. ed. Boston: Houghton-Mifflin Company, 1982, p. 5.
- ³ Gumpert, David E. *Keeping Informed Entrepreneurship: A New Literature Begins*. Harvard Business Review, March-April 1982, p. 50.
- ⁴ U.S. Small Business Administration. *Your Business and the Small Business Administration*. Washington, D.C.: U.S. Government Printing Office, December 1980.
- ⁵ U.S. Small Business Administration. *The State of Small Business: A Report of the President*. Washington, D.C.: U.S. Government Printing Office, 1982, p. 53-54.
- ⁶ Schumpeter, Joseph. *The Theory of Economic Development*. Cambridge: Harvard University Press, 1949, p. 74.
- ⁷ Rand, Ayn. *For the New Intellectual*. New York: Signet, 1961, p. 94.
- ⁸ Timmons, Jeffrey A.; Smollen, Leonard E.; and Dingee, Alexander L., Jr. *New Venture Creation*. Homewood, Illinois: Richard D. Irwin, Inc., 1977, p. 142.
- ⁹ Vesper, Karl H. *New Venture Strategies*. Englewood Cliffs, New Jersey: Prentice-Hall, Inc., 1980.
- ¹⁰ Baty, Gordon B. *Entrepreneurship for the Eighties*. Reston: Reston Publishing Company, Inc., 1981.

We thank the above authors for permission to reprint from their work.

For further information, consult the lists of sources in the *Resource Guide*.

PACE



- Unit 1. Understanding the Nature of Small Business
- Unit 2. Determining Your Potential as an Entrepreneur
- Unit 3. Developing the Business Plan
- Unit 4. Obtaining Technical Assistance
- Unit 5. Choosing the Type of Ownership
- Unit 6. Planning the Marketing Strategy
- Unit 7. Locating the Business
- Unit 8. Financing the Business
- Unit 9. Dealing with Legal Issues
- Unit 10. Complying with Government Regulations
- Unit 11. Managing the Business
- Unit 12. Managing Human Resources
- Unit 13. Promoting the Business
- Unit 14. Managing Sales Efforts
- Unit 15. Keeping the Business Records
- Unit 16. Managing the Finances
- Unit 17. Managing Customer Credit and Collections
- Unit 18. Protecting the Business

Resource Guide

Instructors' Guide

Units on the above entrepreneurship topics are available at the following three levels:

- Level 1 helps you understand the creation and operation of a business
- Level 2 prepares you to plan for a business in your future
- Level 3 guides you in starting and managing your own business



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